A LETTER

TO THE

RIGHT HON. LORD VISCOUNT MELBOURNE.

Second Edition, with Additions.

Price Three Shillings.

LONDON:
PRINTED BY T. BRETTELL, RUPERT STREET, HAYMARKET.

A LETTER

TO

THE RIGHT HONOURABLE

LORD VISCOUNT MELBOURNE,

ON THE

CAUSES OF THE RECENT DERANGEMENT

IN

THE MONEY MARKET,

AND ON

BANK REFORM.

BY

R. TORRENS, Esq., F.R.S.

Second Edition, with Additions.

LONDON:
LONGMAN, REES, ORME, BROWN, & GREEN,
PATERNOSTER ROW.

1837.

ADVERTISEMENT TO THE SECOND EDITION.

THE manner in which Bank Deposits extend the medium of Exchange, having excited considerable attention, I have, in this Edition, reprinted from Mr. Tooke's first Letter to Lord Grenville, the paper in which Mr. Pennington first propounded the principles, that Deposits perform the functions of money; and that a given amount of cash may serve as the basis of a much larger amount of Deposits. Mr. Pennington has favoured me with a more recent paper, explaining, in detail, the operation of these principles. This paper, which is printed in the Appendix, will be read with interest, by all whose pursuits, whether of business or of science, lead them to observe the fluctuations of the Money Market.

LETTER

TO THE

RIGHT HONOURABLE

LORD VISCOUNT MELBOURNE.

My Lord,

In the approaching session of Parliament, our banking system, and its influence upon commercial credit, will demand the early attention of the Legislature. Without occupying your Lordship's time with any preliminary observations, I request permission to offer the following considerations upon these very important subjects.

In order to obtain an accurate knowledge of the causes which have produced the recent disturbance in the money market, it is necessary that we should have a distinct perception of the several component parts of which our money actually consists. Now, it will be found, that in consequence of the system of banking which prevails in this

country, our money is composed of two distinct and different elements, namely, of circulating money, and of credit money; the circulating money consisting of the coin and bank notes actually in circulation; the credit money consisting of the deposits placed in the hands of bankers, and of the cash credits granted by them.

The manner in which that portion of the medium of exchange, which consists of coin and of bank notes, acts upon prices, and, through prices, upon the foreign exchanges, is sufficiently apparent, and needs no explanation. But neither the members of the Government, nor the directors of the Bank of England, appear to be aware of the extensive influence which is exerted upon prices, and, through prices, upon the foreign exchanges, by that portion of the medium of exchange which consists of deposits and cash credits. This *terra incognita* of our monetary system it therefore becomes necessary to explore.

Bank Deposits perform the functions of Money.

When a merchant opens an account with a solvent bank, by depositing cash to the amount of 1000*l.*, he has exactly the same command

of money, exactly the same power of making payments, and of making purchases, which he would have possessed had he kept cash to the amount of 1000*l.* in his own desk. It is evident, therefore, that the 1000*l.* thus deposited are not withdrawn from circulation, and do not cease to form a part of the medium of exchange by being transferred from the desk of the merchant to the coffer of the bank. To a merchant who has, in a solvent bank, a deposit against which he can draw his checks, that deposit is *money*. But the case of an individual merchant having a deposit with a bank, is the case of all other persons who keep their cash with bankers. It is evident, therefore, that all the deposits in all the solvent banks throughout the country perform the functions of money, form a part of the medium of exchange, and act upon prices, and upon the foreign exchanges, exactly in the same way, and to the same extent, in which the same amount in coin and bank notes would act upon prices and upon the foreign exchanges.

As deposits made with banks perform all the functions of money, it is necessary to consider in what way, and to what extent, the practice, now become so general, of keeping cash with bankers, increases the power of

the medium of exchange. This is a question which the directors of the Bank of England appear never to have attended to. Nevertheless, it is one of the greatest importance; and I therefore solicit your Lordship's indulgence, while I endeavour to arrive at a correct solution of it.

When merchants and others transfer coin and bank notes from their own desks to the hands of their bankers, the operation would not have the effect of contracting the currency, even though the bankers should keep the whole of the coin and notes transferred to their custody, locked up in their coffers until drawn out by the depositors. The following illustration will make this apparent.

Let us assume that the merchants and dealers within the metropolitan district, require, for the conducting of their business, circulating money to the amount of 10,000,000*l.*, and that they actually hold this amount in coin and Bank of England paper. This being the previous state of things, let us assume again, that these merchants and dealers open accounts with the London bankers, and place with them, as deposits, the 10,000,000*l.*, in coin and notes, which they before kept in their own desks. Now this change in the manner of keeping the

cash required to meet the current demands of the market, would not leave the merchant and dealer with a less command of money, with a less power of making payments and of making purchases, than they before possessed. By drawing checks upon their bankers to the amount of 10,000,000*l.*, they can come into the market just as effectually as they could before have done by bringing out coin and notes to that amount from their own cash boxes. If the whole of the 10,000,000*l.* in coin and notes, deposited with the bankers, were locked up in their coffers until drawn out in payment of the checks of the depositors, this locking up of coin and notes would have no conceivable effect in depriving the depositors of the power of drawing checks, and of making payments or purchases to the amount of the 10,000,000*l.* It is evident, therefore, that transferring coin and bank paper from the desks of merchants and others, and placing them for safe custody as bank deposits, could have no effect whatever, either in contracting or in expanding the currency, *even if the whole of the coin and bank paper so transferred were locked up in the coffers of the bank, until withdrawn in payment of the checks of the depositors.* But the whole of the coin and notes deposited

with the banks would not be locked up until required in payment of the checks drawn by the depositors. Bankers make their profit by lending, upon available securities, the greater part of the sums deposited with them by their customers. When our merchants and dealers deposited 10,000,000*l*. with the banks, the bankers would retain a part of the sum—say 2,000,000*l*. as a reserve, or rest, for the purpose of making occasional payments over their counters, and would employ the other 8,000,000*l*. in the purchase of stock, or of exchequer bills, or in the discount of bills of exchange. Now, it is self-evident that this would occasion an extension of the general medium of exchange. The merchants and others, who had deposits with the bankers to the amount of 10,000,000*l*., would be just as able as they were before to come into the market, and make payments and purchases to the amount of 10,000,000*l*.; while the persons who sold the stock, and the exchequer bills, or who obtained the discounts, would be able to come into the market, and effect payments, and make purchases, to the amount of 8,000,000*l*. Thus, in this case, which has been taken for illustration, the operation of the private banks in receiving deposits, and in investing

them in available securities, would have the effect of increasing the circulating medium by 8,000,000*l*.

By the foregoing illustrations, two important principles have, as I believe, been established. 1*st.*—That deposits with solvent banks form a component part of the general medium of exchange, and perform the functions of money just as effectually as the coin and bank notes actually in circulation. 2*nd.*—That the practice of merchants and others, in keeping their cash with bankers, and the practice of bankers in employing the cash thus placed in their hands, have the effect of increasing the general medium of exchange, by the amount of that portion of the cash of their customers, which bankers may find it prudent to employ. These principles being established, it will be necessary, in order to obtain a distinct and complete view of the effect produced upon the currency, by the system of banking which prevails in this country, to consider the circumstances which determine the proportion between the amount of deposits standing in the books of bankers, and the amount of the coin and bank notes which they employ in meeting occasional demands.

In periods of confidence and high commercial credit, a small amount in coin and

bank notes, may serve as the basis of a large amount of bank deposits. It follows, that in such periods, the circulating medium may expand, without any increase in the amount, either of coin or of bank notes; and that, while the amount of coin and notes remains undiminished, the circulating medium may suffer contraction. The expansion and contraction of the currency, resulting from an increase or diminution of bank deposits, is a subject of the greatest practical importance; and as it is a subject which appears to have been overlooked by every writer upon the science of money, with the single exception of Mr. Pennington, I am under the necessity of again soliciting your Lordship's attention, while I endeavour to explain it.

A given amount of circulating Cash becomes the basis of a much greater amount of Bank Deposits.

In order to place the effect of bank deposits in enlarging the medium of exchange, in a clear and distinct point of view, let us assume that there are no bank notes employed in the district of the metropolis, and that, in this district, the coin retained in circulation amounts to 15,000,000*l.*, of which, 5,000,000*l.* are in the hands of

persons who do not employ bankers, and 10,000,000*l.* belong to merchants and others, who do employ bankers. In this case, if the bankers kept the whole of their deposits of 10,000,000*l.* locked up in their coffers, the currency of the metropolis would still amount to 15,000,000*l.*; and would consist of 5,000,000*l.* of coin, circulating amongst those who did not keep their cash with bankers, and of 10,000,000*l.* of deposits, belonging to merchants and others, who did employ bankers. But it is quite certain, that the bankers would not keep the whole of the 10,000,000*l.* deposited with them, locked up in their coffers. They would re-issue the greater part of the sum, say 8,000,000*l.*, in the discount of mercantile bills, or in the purchase of government securities; and therefore the money of the metropolis, instead of being, as before, 15,000,000*l.*, would be 25,000,000*l.* *viz.*

	£.
Coin in the hands of persons not keeping cash with bankers	5,000,000
Deposits placed to the credits of persons employing bankers	10,000,000
Coin issued by the banks upon securities	8,000,000
Coin resting in the banks	2,000,000
	£.25,000,000

Under the circumstances which have been assumed for the sake of illustration, the persons not employing bankers, and requiring, for their purchases and payments, money to the amount of 5,000,000*l.*, are already in possession of that sum; and this being the case, the 8,000,000*l.* which the bankers took from their deposits, and issued upon securities, would be immediately returned upon them, in the form of new deposits. Taken collectively, the liabilities and assets of the banks would now stand thus :—

	Deposits. £.	*Coin.* £.	*Securities.* £.
Liabilities ...	18,000,000		
Assets		10,000,000	8,000,000

The 10,000,000*l.* which the banks would now again possess, would be found more than sufficient to meet the occasional demands of the customers, who owned the 18,000,000*l.* of deposits; the bankers would feel themselves fully justified in employing a considerable portion, say 6,000,000*l.* out of 10,000,000*l.* upon securities, and in retaining a rest of only 4,000,000*l.* to meet occasional demands.

Now, as the persons who do not keep cash with bankers, already have the 5,000,000*l.* of currency, which is sufficient for their

transactions, the whole of this second re-issue of coin by the banks would be again returned to them in the form of new deposits. Therefore, the aggregate account of the liabilities and assets of the bankers would now be as follows:—

	Deposits. £.	*Coin.* £.	*Securities.* £.
Liabilities ...	24,000,000		
Assets		10,000,000	14,000,000

The bankers would still find that a reserve or rest of 10,000,000*l.* in coin would be more than sufficient to meet the occasional demands of the customers who had credit on their books for the 24,000,000*l.* of deposits. A part of this coin would be again advanced upon securities, and would be again returned upon the banks, in the form of new deposits, restoring their reserve or rest to the original sum of 10,000,000*l.* The *modus operandi* is sufficiently obvious. Whatever may be the amount of the circulating money, one portion of it will be in the hands of those who do not keep their cash with bankers; while the remaining portion will be in the hands of those who do keep their cash with bankers. Now, if that portion of the circulating money which is at the command of those who keep their cash with bankers, amounts to 10,000,000*l.*, the bankers, at the close of each day's business, will have 10,000,000*l.* in

their coffers. Whatever sums they may advance upon securities in the morning, the same sums will be returned to them in the evening, in the form of new deposits; and in this way the amount of their deposits must continue to increase, until they bear that proportion to the fixed amount of the returning cash, which the experience of the bankers may suggest as safe and legitimate. In the case which I have taken for illustration, the bankers of the metropolis have coin constantly returned to them to the amount of 10,000,000*l.*; and should they consider it safe to re-issue this returning coin upon securities, until their liabilities bore to their cash the proportion of ten to one, then their aggregate account would stand thus:—

	Deposits. £.	*Coin.* £.	*Securities.* £.
Liabilities ...	100,000,000		
Assets		10,000,000	90,000,000

But should the bankers deem it unsafe to let the amount of their liabilities exceed that of their returning cash, by a greater proportion than five to one, then the aggregate account of their liabilities, cash, and securities, would be as follows:—

	Deposits. £.	*Coin.* £.	*Securities.* £.
Liabilities ...	50,000,000		
Assets		10,000,000	40,000,000

Thus we see that, in consequence of the system of banking prevalent in this country, a fixed amount of circulating money may be the basis of a fluctuating amount of credit money, even though the circulating money should be purely metallic. It would be difficult to say in how great a proportion, during periods of high commercial confidence, the amount of credit money might exceed the amount of the circulating money on which it is based; and we can imagine extreme cases of general panic, in which the superstructure of credit money might almost entirely disappear. The medium of exchange in this country is a complicated and delicate machine, requiring, for its due regulation, the strictest application of scientific principles.

No accounts are published, showing the proportion which the deposits made with private bankers, bear to the cash which such bankers hold, for meeting occasional demands; this proportion will necessarily vary with the variations of commercial confidence. When trade is prosperous, when few failures are occurring, and when commercial bills are promptly paid as they fall due, bankers might consider it safe to continue to re-issue, upon securities, the cash returning upon them as deposits, until the proportion between their

deposits and their cash, became as fifteen to one, or even as twenty to one. In periods of commercial pressure, on the other hand, bankers would be disposed to contract their liabilities, until the deposits which they might be called upon to pay on demand, bore to their cash a proportion, not exceeding seven to one, or even five to one. We have, however, no precise data enabling us to ascertain, at any particular period, the proportion which private bankers maintain, between their deposits and their cash. Mr. Clay, whose practical and scientific knowledge of the money market, renders him a high authority upon such subjects, stated, in the House of Commons, when moving for the appointment of the Select Committee upon Joint-Stock Banks, that, in ordinary times, one tenth, or even one twentieth, of the money deposited with a banker, is a sufficient rest for meeting occasional demands; and that nine-tenths, or even nineteen-twentieths, of the sums deposited with a bank, may be lent out on securities, bearing interest. This is sufficient proof that I should not be arguing on an extreme case, were I to assume that the cash originally deposited by those who keep their accounts with bankers, will be successively re-issued upon securities, by the banks, and

successively returned to them, in the form of new deposits, until the proportion between the amount of the deposits, and the amount of the cash, is as ten to one. But though it might be justifiable, yet it is unnecessary, to resort to a case so strong. The charge of mis-management which I have to prefer against the bank directors, will be sufficiently made out, if we take the proportion as low as five to one.

Effect of the Foreign Exchanges upon a Currency consisting of Circulation and Deposits.

It will now be necessary, before I proceed to state and establish the charge of mis-management, to examine the effect of the foreign exchanges, in contracting and expanding a currency consisting of coin, and of bank deposits. Let us assume, as before, that the reserve, or rest, in the hands of the bankers of the metropolis, amounts to 10,000,000*l.* in coin; that the proportion which they usually preserve between their deposits and their reserve of cash, is as five to one; and that, therefore, the whole amount of the money, including cash and deposits, at the command of the bankers, and of their

customers, amounts to 60,000,000*l.* This being the previous state of things, let us suppose that the exchanges become adverse, and that the merchants withdraw from the banks 1,000,000*l.* of gold for exportation. By this withdrawal and exportation of specie, the reserve of cash in the hands of the bankers will be reduced from 10,000,000*l.* to 9,000,000*l.*; and the bankers, in order to protect themselves, will find it necessary to reduce their liabilities, in a similar proportion. Assuming that five to one is considered as the proper proportion to be maintained between the amount of deposits and the amount of rests, then the bankers, in the case just stated, would proceed to reduce their deposits from 50,000,000*l.* to 40,000,000*l.* This they would be able speedily to effect. As cash came in, in payment of the bills they had discounted, they would not re-issue it upon new discounts, and therefore could not receive it back in the form of new deposits; they would abstain from discounting, until their advances to their customers were reduced from 50,000,000*l.* to 40,000,000*l.*; and until, by a necessary consequence, the cash which their customers could command and deposit, was reduced by a similar amount.

A favourable exchange would produce op-

posite results. Should the influx of gold increase the cash in the hands of the bankers from 10,000,000*l.* to 12,000,000*l.*, the bankers would discount more freely, and the cash successively advanced in discount, would successively return in the form of new deposits; and thus the increase of the reserves or rests in the hands of the bankers from 10,000,000*l.* to 12,000,000*l.* would be speedily followed by an increase of the sums paid in to them as deposits from 50,000,000*l.* to 60,000,000*l.*

And now the ground has been sufficiently cleared, to enable us to trace the manner in which the directors of the Bank of England have mismanaged the currency.

The Directors of the Bank of England have departed from the sound principle of leaving the Currency to expand and contract under the action of the Foreign Exchanges.

The directors of the Bank of England profess to act upon the principle of regulating their issues so as to allow the currency to expand and contract, as the foreign exchanges become favourable or adverse. It is unquestionable that this is a sound principle; and that, were it acted upon, the currency would always be maintained in the same state, with

respect both to amount and to value, in which it would exist were the circulation composed exclusively of the precious metals. If the circulation were purely metallic, and consisted of 30,000,000*l.* of sovereigns, a favourable exchange, causing an importation of gold to the amount of 2,000,000*l.*, would increase the circulation from 30,000,000*l.* to 32,000,000*l.*; while an adverse exchange, causing an exportation of gold to the amount of 2,000,000*l.* would contract the circulation from 30,000,000*l.* to 28,000,000*l.* In like manner, if the circulation consisted of 30,000,000*l.*, in bank notes, and if the principle of allowing the circulation to expand and contract under the influence of the foreign exchanges were acted upon, a favourable exchange, causing an importation of gold to the amount of 2,000,000*l.* would cause bullion to the amount of 2,000,000*l.* to be poured into the Bank in exchange for notes, and would thus increase the circulation from 30,000,000*l.*, to 32,000,000*l.*; while on the other hand, an adverse exchange, causing an exportation of gold to the amount of 2,000,000*l.* would cause Bank notes to the amount of 2,000,000*l.* to be returned upon the Bank in exchange for the gold required for exportation, and would thereby reduce the circulation from 30,000,000*l.* to 28,000,000*l.*, as certainly

as if the circulation had consisted exclusively of gold.

Thus it is strictly demonstrable, that if the directors of the Bank of England acted upon the principle by which they profess to be guided, of allowing the currency to expand and contract under the action of the foreign exchanges, the circulating medium would be maintained in the same state, both with respect to volume and to value, in which it would exist were there no Bank notes in existence, and were the current money exclusively metallic. Now the charge which I bring against the directors of the Bank of England is, that instead of conforming to the sound principle by which they profess to be guided, they act in systematic violation of it. The proofs of this grave charge are exhibited in the accounts published under the authority of Parliament. These accounts, therefore, I proceed to examine.

The following table, showing the liabilities and the assets of the Bank of England, from December 1833, to June 1836, is printed in the Report of the Select Committee of the House of Commons, on Joint-Stock Banks, &c.

	Circulation.	Deposits.	Bullion.	Securities.
	£.	£.	£.	£.
28 Dec. 1833	17,469,000	15,160,000	10,200,000	24,567,000
29 Mar. 1834	18,544,000	13,750,000	8,753,000	25,787,000
28 June, „	18,689,000	15,373,000	8,885,000	27,471,000
27 Sept. „	18,437,000	12,790,000	6,917,000	26,915,000
28 Dec. „	17,070,000	13,019,000	6,978,000	25,551,000
28 Mar. 1835	18,152,000	9,972,000	6,295,000	24,533,000
27 June, „	17,637,000	11,753,000	6,613,000	25,221,000
26 Sept. „	17,320,000	13,866,000	6,284,000	27,724,000
26 Dec. „	16,564,000	20,370,000	7,718,000	31,764,000
26 Mar. 1836	17,669,000	12,875,000	8,014,000	25,521,000
25 June, „	17,184,000	15,730,000	6,868,000	28,847,000

An inspection of this table will convince your Lordship of the correctness of my assertion, that the Bank directors act in systematic violation of the principle of leaving the currency to contract and expand under the action of the exchanges. In December 1833, their circulation was 17,469,000*l.*, and their bullion 10,200,000*l.*; in March 1834, their bullion was reduced to 8,753,000*l.*; and if they had acted on the principle of leaving the currency to contract under the action of an adverse exchange, their circulation would have been reduced to 16,022,000*l.* But what was the fact? In utter disregard of the only sound principle upon which a paper currency can be regulated, the Bank directors, while bullion was thus flowing from their coffers, increased their circulation to

18,544,000*l.*; and thus threw upon the money market an excess of circulating money to the amount of 2,522,000*l.*

In March 1835, the treasure in the coffers of the Bank was reduced from 10,200,000*l.*, its amount in December 1833, to 6,295,000*l.*; and if the directors, during this continued adverse exchange, had allowed their issues to contract as their gold was withdrawn, their circulation would have been reduced from 17,469,000*l.*, its amount in December 1833, to 13,564,000*l.* Yet, incredible as the fact may appear (and utterly incredible it would be, if not established by authentic official returns), the directors kept out a circulation of 18,152,000*l.*, and thus created in the money market an excess of paper to the amount of 4,588,000*l.*

The continuance of the adverse exchange, was the necessary result of this excess in the circulation. The Gazette account of the quarterly averages of liabilities and assets of the Bank of England, from the 23rd of August to the 15th of November, 1836, gives the following results:—

Liabilities.		*Assets.*	
Circulation ...	£.17,543,000	Securities ...	£.28,134,000
Deposits	12,682,000	Bullion	4,933,000
	£.30,225,000		£.33,067,000

Taking these figures as they stand, without

troubling ourselves to inquire how much the actual quantity of bullion, held by the Bank during the last week of the quarter, fell short of the average of the whole quarter (which is all the return gives), we shall still have sufficient data to show the monstrous extent to which principle has been departed from in the regulation, or rather, in the no regulation, of the currency. Between December 1833, and November 1836, the treasure in the coffers of the Bank was reduced from 10,200,000*l.* to 4,933,000*l.*; while the issues of the Bank of England paper were increased from 17,469,000*l.* to 17,543,000*l.*! How did the directors contrive to get out more paper while the adverse exchange was depriving them of gold? Simply by violating the principle by which they profess to be guided. While the adverse exchange was reducing their treasure from 10,200,000*l.* to 4,933,000*l.*; and while, on every sound principle, they should have allowed their paper in circulation to contract from 17,469,000*l.* to 12,202,000*l.*, they increased their securities from 24,567,000*l.*, their amount in December 1833, to 28,134,000*l.*, their average amount for the quarter ending the 15th of November, 1836; and by issuing paper on the increased amount of securities, succeeded in causing the currency to expand,

under the action of a decided and protracted adverse exchange.

The Bank Directors have failed to distinguish between the different effects produced upon the medium of Exchange by a contraction of their Issues, and by a contraction of their Deposits.

It may be objected to the view which I have here taken of the conduct of the Bank, that its liabilities consist of its circulation, and of its deposits; and that the practical rule adopted by the directors, is, not to allow their circulation to contract and expand under the action of the foreign exchanges, but to keep their securities even, and to allow their whole liabilities, including circulation and deposits, to contract and expand under the influences of the exchanges. Now it certainly does appear, from the published accounts, that when the circulation of the Bank has been increased, their deposits have generally been diminished by an approximating amount; and it is therefore only fair to infer, that the practical rule adopted by the directors, is to keep their securities even, and to allow, not their circulation, but their whole liabilities, including both circulation and deposits, to expand or

contract under the action of the foreign exchange. But this is no answer to the grave charge of mismanagement, which I prefer against the Bank directors; because the adoption of such a rule is contrary to the principle* of leaving the currency to expand or contract under the action of the foreign exchange, and is, in itself, as decisive a proof of mismanagement, and of departure from principle, as it is possible to conceive. The currency, or general medium of exchange, is composed of two distinct and different elements, namely:—of the circulating money, consisting of coin and Bank notes, and of the credit money, consisting of all those deposits and credits which stand in the books of bankers, and which are available in effecting purchases and payments. Now if these two elements were constantly equivalent, if the amount of the circulating currency were always equal to that of the credit currency, then it would be a matter of indifference, whether the Bank directors allowed the foreign exchanges to act upon their circulation, or to act upon their deposits. But, as has already been demonstrated, a given amount of circulating currency becomes the basis of a far greater amount of credit cur-

* See Note at the end.

rency. Therefore, the Bank directors, in allowing the foreign exchanges to act, not upon their circulation, but upon their deposits, exhibit a lamentable ignorance of the principles upon which the issue of Bank paper ought to be regulated.

It is universally admitted, by persons acquainted with monetary science, that paper money should be so regulated as to keep the medium of exchange, of which it may form a part, in the same state, with respect to amount and to value, in which the medium of exchange would exist, were the circulating portion of it purely metallic. Now, it is self-evident, that if the circulating currency were purely metallic, an adverse exchange, causing an exportation of the metals to any given amount, would occasion a contraction of the circulating currency to the same amount; and that a favourable exchange, causing an importation of the metals to any given amount, would cause an expansion of the circulating currency to the same amount. Therefore, when the directors of the Bank of England allow, not their circulation, but their deposits, to contract and expand under the influence of the foreign exchanges, they depart from the only sound principle upon which paper money can be regulated. If the circulating currency of the metropolis consisted of gold, an adverse exchange, causing an export-

ation of gold to the amount of £.1,000,000 would withdraw from circulation one million of sovereigns; and therefore, as the circulating currency of the metropolis consists of Bank of England notes, an adverse exchange, causing one million in bullion to be withdrawn from the Bank, would require to have 1,000,000*l.* of Bank notes withdrawn from circulation. As often as an adverse exchange abstracts any given amount of treasure from the Bank, without a withdrawal to the same amount of Bank of England notes from circulation, so often do the directors of the Bank of England exhibit a practical proof of their incompetency to perform the important function of regulating our monetary system. To say that their rule is to keep their securities even, and to allow the exchanges to act upon their whole liabilities, is not a defence, it is an admission that they do not understand their business.

In order to obtain a correct view of the extent to which the mismanagement of the affairs of the Bank of England has been carried, it will be necessary to state, in figures, the difference between the effects produced by a contraction of the circulation of the Bank, and those produced by a diminution of its deposits. I have already shown, that under the existing system of London banking, a given amount of circulating currency forms

the basis of a much larger amount of credit currency. On the principle stated by Mr. Clay, that, in ordinary times, bankers may employ upon securities nine-tenths, or even nineteen-twentieths of the sums deposited with them, a circulating currency, consisting of Bank notes to the amount of 1,000,000*l.*, may be the basis of a credit currency, consisting of deposits to the amount of 10,000,000*l.*, or even to the amount of 20,000,000*l.* I do not, however, avail myself of the very competent authority of Mr. Clay for the purpose of giving a highly coloured picture of Bank of England mismanagement. I take as the datum of my reasonings the moderate supposition that bankers employ, upon securities, only four fifths of the sums deposited by their customers; and that, consequently, a circulating currency, consisting of 1,000,000*l.* of Bank notes, forms the basis of a credit currency of 5,000,000*l.*

When the treasure in the coffers of the Bank, decreased from 10,200,000*l.*, its amount in December 1833, to 8,753,000*l.*, its amount in March 1834, the diminution of treasure to the amount of 1,447,000*l.* should have been accompanied by a withdrawal of Bank of England notes from circulation to the amount of 1,447,000*l.* Had this been done, the aggregate amount of circulating cash returning

upon the private banks of deposit at the close of each day's business, would have been reduced by 1,447,000*l.*; and therefore these banks, supposing that they acted upon the principle of not allowing the amount of their liabilities to exceed the amount of their daily returning reserve of cash by a greater proportion than that of 5 to 1, would have reduced their advances upon securities, until the sums advanced, and again returned to them in the form of deposits, had been reduced by an amount five times greater than the amount of the Bank of England notes withdrawn from circulation. Hence, while the amount of the circulating currency was reduced by 1,447,000*l.*, the amount of the credit currency would have been reduced by 7,235,000*l.*; and the total reduction in the general medium of exchange, which acts upon prices and on the foreign exchanges, would have been 8,682,000*l.* But the directors of the Bank of England, instead of withdrawing 1,447,000*l.* Bank notes from circulation, as treasure to that amount was abstracted from their coffers, increased their circulation by 1,075,000*l.* and (bankers preserving the proportion of 5 to 1 between their cash and their liabilities) this extension of the circulating currency would have occasioned an extension of the credit currency to the amount of 5,375,000*l.*, being an en-

largement of the general medium of exchange to the amount of 6,450,000*l*. But from this we have to deduct 1,410,000*l*., for the reduction in the amount of the deposits of the Bank of England from December 1833 to March 1834; and therefore the aggregate increase in the general medium of exchange effected by the operations of the Bank of England between December 1833 and March 1834, was 5,040,000*l*.

From the analysis now given of the accounts of the Bank of England, published by order of the House of Commons, the charges against the directors amount to this. By departing from the only sound principle upon which paper money can be regulated, they occasioned, between December 1833 and March 1834, an undue extension of the medium of exchange, which, at a moderate estimation, may be taken at 13,600,000*l*. Had they allowed the adverse exchange to contract their paper circulation, to the same extent to which it would have contracted a metallic circulation, the circulating currency would have been reduced by the actual amount of 1,447,000*l*.; while the credit currency would have been reduced by the probable amount of 7,235,000*l*. But, disregarding this legitimate rule, and allowing the adverse exchange to act upon their deposits, instead of upon their circulation, the Bank

directors increased the circulating currency to the actual amount of 1,075,000*l.*; and the credit currency by the probable amount of 5,375,000*l.*

It is painful but necessary, to pursue the analysis. In March 1835, the treasure in the coffers of the Bank, was reduced from 10,200,000*l.*, its amount in December 1833, to 6,295,000*l.*, and, on all sound principles, the Bank directors ought to have reduced their issues from 17,469,000*l.*, their amount in December 1833, to 13,564,000*l.*, This would have effected a reduction in the circulating currency to the actual amount of 3,905,000*l.*, and a reduction in the credit currency, to the probable amount of 19,525,000*l.*, making a total reduction in the medium of exchange, of about 23,430,000*l.* But, in their systematic disregard of principle, the Bank directors increased their issue of Bank notes, from 17,469,000*l.* to 18,152,000*l.*, and thus added 683,000*l.* to the actual amount of the circulating currency, and 3,415,000*l.* to the probable amount of the credit currency; they caused a total expansion of the medium of exchange, to the amount of 4,098,000*l.*, under circumstances which, had the circulating currency been metallic, or had the issue of Bank paper been regulated on sound principles, would have

occasioned a contraction to the amount of 23,430,000*l.*

From the 23rd of August, to the 15th of November, 1836, the average amount of treasure held by the Bank of England was 4,933,000*l.*, being less, by 5,267,000*l.*, than the amount held in December 1833, while the amount of Bank of England notes in circulation, was increased to 17,543,000*l.*, being more by 74,000*l.* than the amount of Bank of England notes in circulation in December 1833.

By the gazette account of the assets and liabilities of the Bank of England, from September 20th to December 13th of the present year, it appears that the average amount of treasure during the quarter, had declined to 4,545,000*l.*, being less by 5,655,000*l.* than its amount in December 1833, and that the average amount of Bank of England notes in circulation during the quarter was 17,361,000*l.*, being less by 108,000*l.*, than the amount in circulation in December 1833. Thus, the directors of the Bank of England, after losing 5,655,000*l.* of their treasure—urging the Chancellor of the Exchequer to raise the rate of interest upon exchequer bills, because the currency was in excess—paralysing our export trade, by refusing American bills, in order to check the exportation of gold to the United States—

and spreading distrust and alarm throughout the country, until we approached the verge of a domestic panic, which threatened to destroy the whole superstructure of credit currency, and brought the Bank of England itself in danger of stopping payment — at length adopted the precaution of contracting their circulation to the amount of **108,000*l*.**!!

Insufficiency of the Defences set up for the Bank Directors.

The advocates of the Bank of England bring forward a variety of statements, for the purpose of showing, that the directors cannot always conform to the principle of leaving their circulation to expand and contract under the action of the exchanges; and that if they were to conform to this principle, derangements in the money market would be occasioned, by the operations of other parties, for whose errors the Bank directors cannot be held responsible. The insufficiency of defences, resting upon such statements, I will endeavour to make manifest.

1*st.*—It may be urged in refutation of the charge of mis-management here brought against the Bank directors, that the foregoing calculations, respecting the extent to which their adherence to sound principles would

have contracted the medium of exchange, are overcharged, and extravagant in the highest degree; and that, on whatever principles the Bank directors might have acted, it would have been utterly impossible for them to have effected, between December 1833 and March 1836, a contraction of the medium of exchange to the enormous extent of 23,000,000*l.*; because, before a contraction approaching to this extent could have been effected, there would have been such a fall of prices, and such a decrease of imports and increase of exports, as must have turned the exchanges in our favour, and have caused an influx of the precious metals, requiring the issue of an increased amount of paper in exchange for the gold poured in upon the Bank.

This argument proves too much; and, by proving too much, serves, not to refute, but, on the contrary, to confirm the charge of mismanagement brought against the Bank. It is quite true, that, between December 1833 and March 1836, a contraction of the medium of exchange to the extent of 23,000,000*l.* could not by possibility have been effected; but then it is equally true, that had the Bank directors regulated their issues upon sound

principles, the circumstances indicating such a degree of contraction never could have arisen. If the directors had withdrawn their notes from circulation, as bullion was withdrawn from their coffers, it is probable that, before their treasure could have been reduced from 10,200,000*l.* to 8,000,000*l.*, the exchanges would have been turned in our favour. Had the first exportation of gold, to the amount of 2,000,000*l.*, been accompanied by a withdrawal of Bank of England notes to a like amount, the amount of the cash returning to the banks of deposit, at the close of each day's business, would have been reduced by 2,000,000*l.*, and this contraction of the circulating currency would have occasioned, in the manner already explained, a contraction of the credit currency, amounting, it is probable, to 10,000,000*l.* Thus there would have been a total contraction of the medium of exchange to the amount of 12,000,000*l.*, and it cannot be doubted but that this contraction would have been sufficient to have brought our currency to par with foreign currencies, and to have arrested the efflux of the precious metals. The considerable and long-continued drains to which the coffers of the Bank of England

have hitherto been liable, could never have occurred, had the Bank directors regulated their issues upon sound principles.

2nd.—It has been urged, in defence of the conduct of the directors of the Bank of England, that they have two separate and opposite functions to perform; namely, to regulate the currency, and to support commercial credit; that, in the performance of these opposite functions, it is found impossible to act upon the same uniform system; and that, in particular states of the money market, it becomes necessary to depart from general principles, and to avert a domestic panic, by issuing an increased amount of Bank paper, even during the continuance of an adverse exchange.

This defence of the Bank requires to be scrutinised. As the directors consider it to be a part of their duty to watch over, and sustain the commercial credit of the country, it becomes necessary to examine under what circumstances, and in what manner, they can be required to perform so important a function.

It is evident that the directors of the Bank of England can have no power to relieve any species of commercial pressure, except that which may be occasioned by a derangement of

the currency. The cessation of foreign consumption; the springing up of foreign rivals; the deterioration of domestic industry; errors in commercial and financial legislation; may each, and all, occasion a temporary depression, or a permanent decline of trade, unconnected with the state of the currency, and incapable of correction by any banking operation. Nor is this all. Commercial pressure, even when solely occasioned by a contraction of the circulating medium, cannot, in the majority of instances, be removed by any measure, which it is within the province of the Bank of England to adopt. A convertible paper currency must conform to the standard of value which it represents. While gold at a mint price of 3*l.* 17*s.* 10½*d.* per ounce, continues to be our standard of value, every cause which raises the value of gold, must have the effect of contracting the currency, and of producing that pressure upon trade, which results from a fall of prices. Now the value of gold may be raised in a variety of ways; by alterations in the import duties, either of this or of other countries; by changes in the mint regulations of foreign states, or by a loss of that relative superiority, in producing articles of export, which enables us to command a

larger proportion of the precious metals, than is commanded by other countries. Now it is self-evident, that the Bank of England cannot supply a remedy against contractions of the circulating medium, proceeding from causes such as these. What, then, is the nature, and what the cause, of that contraction of the currency, and of that pressure upon commercial credit, against which the Bank of England can supply a remedy? To this question, which is an important one, I shall endeavour to give a distinct answer.

When an excessive issue of Bank paper has rendered our currency redundant, in relation to foreign currencies, the exchanges turn against us, and gold is demanded for exportation; and when, at the same time, the Bank directors, disregarding the only sound principle upon which a paper circulation can be regulated, do not draw in their notes, as their treasure is withdrawn, the drain upon their coffers is continued until the Bank is in danger of stopping payment. To avert this danger, the Bank directors resort to a late and violent action on the circulation; they disregard the rule of keeping their securities even; they raise the rate of interest; they refuse bills of unquestionable character; they sell exchequer bills; and thus create alarm and distrust, until that credit currency, by means

of which the far greater number of our commercial transactions are effected, begins to give way. The directors now find that danger approaches from another quarter. The banks throughout the kingdom, whether of deposit or of issue, feel more or less of pressure, and become desirous of contracting their liabilities, and of increasing their reserve of cash; in proportion as confidence is shaken, gold is preferred to paper, and sovereigns are held rather than the notes of the Bank of England; and a domestic drain, more sudden and more serious than the foreign, threatens to exhaust its coffers.

These are the only circumstances under which it can be necessary that the Bank should exercise its vaunted function of sustaining commercial credit. When the directors have neglected to any considerable extent, to draw in their notes as an adverse exchange draws out their gold, their establishment becomes exposed to two opposite dangers; and they cannot avoid the one, without approaching the other. If they do not *contract* their issues, their treasure may be exhausted by the continual action of the foreign exchange; and if they do not *increase* their issues, their coffers may be emptied by the immediate action of a domestic panic. Of the two dangers, that of

having their coffers emptied by domestic panic, is the most serious and the most pressing; and therefore, in an emergency leaving only a choice of evils, the Bank directors are justified in disregarding the principle of regulating their issues by the foreign exchanges, and in making such advances as may be necessary to restore commercial credit. But does the necessity under which the Bank directors are occasionally placed, of resorting to extraordinary measures for the purpose of mitigating a pressing mischief, afford a justification of the previous deviations from principle by which that mischief was created? Could a surgeon, who had wounded an artery, instead of having opened a vein, vindicate his professional reputation, by showing that he had secured the blood vessel before his patient bled to death? Could an incendiary escape condemnation, by proving that he had laboured at the engine by which the conflagration which he had kindled was at length subdued?

When, in 1826, the Bank directors restored commercial credit, by making extensive issues, regardless of the state of the foreign exchanges, their conduct received, as it deserved, the highest praise; but this conduct, however praiseworthy in itself, cannot be referred to,

in justification of the previous mismanagement of the circulation of the Bank of England, by which the frightful panic of 1826 was occasioned. In like manner, though the conduct of the present directors, in making liberal advances upon mercantile securities, and in affording assistance to the provincial banks, without waiting for an influx of the precious metals, is laudable and wise, yet this conduct, however calculated to avert a more serious crisis, cannot remove the responsibility they have incurred by that earlier departure from principle, which has led to the mitigated panic of the present year. The only disturbances in the money market, which the directors of the Bank of England have any power to correct, are those which their own mismanagement of the currency creates. If they could be prevailed upon to attend with strictness, to their essential duty, of regulating their issues by the course of the foreign exchanges, they would never be called upon to perform the superfluous duty, of watching over and supporting commercial credit. When they cease to inflict disease, they will no longer be required to administer remedies.

3rd.—We hear it frequently and confidently asserted, that the recent disturbance in the

money market, has been occasioned, not by mismanagement on the part of the directors of the Bank of England, but by the excessive issues of paper thrown into circulation by the country banks, and particularly by those which have been formed on joint-stock principles. It is contended that the strictest application, by the directors of the Bank of England, of the principle of allowing the amount of their notes to increase or diminish under the action of the exchange, cannot have the effect of preventing the currency of this country from becoming redundant, in relation to the currencies of other countries, while the paper of the provincial banks, issued without reference to the state of the exchanges, flows into the channels of circulation, as the paper of the Bank of England is withdrawn.

The plea thus set up for the Bank of England, demands serious consideration; because, if valid, it leads to a very important practical conclusion. If it be true, that the principle of leaving the circulation of the Bank of England to expand or contract, under the action of the foreign exchanges, can be rendered inoperative by the issuing of paper by provincial banks, then the necessary inference is, that no provincial banks of issue should be permitted to exist. If the issuing

of paper, by more than one establishment, renders it impossible to preserve the currency in a sound state, that is, in the same state in which it would exist were it purely metallic, then it follows, as a necessary conclusion, that to a single establishment, the exclusive privilege of issuing paper should be given. This conclusion is indeed avowed. The advocates of the Bank of England contend, that its monopoly, with respect to the issuing of paper, instead of being confined to the metropolitan district, should be extended to the country at large.

The assertion that the operations of the provincial banks counteract, and render ineffectual the efforts made by the Bank of England to keep the currency at par with foreign currencies, appears not quite consistent with the previous assertion, that the directors of the Bank of England are prevented from regulating their issues according to the exchanges, by the necessity they are under of supporting commercial credit. Were it true, that the paper of the provincial banks flows into the channels of circulation as the paper of the Bank of England is withdrawn, and thus prevents the currency from contracting under the influence of an adverse exchange, then there would be no narrowing

of mercantile accommodation, and no pressure upon the money market, requiring advances from the Bank of England in support of commercial credit. On the other hand, the fact, so frequently and so fatally experienced, that a contraction of the issues of the Bank of England inflicts immediate pressure on the money market, is a practical demonstration, that the paper of the provincial banks does not flow into the channels of circulation as the paper of the Bank of England is withdrawn; and that the operations of the provincial banks do not counteract the efforts of the directors to regulate the currency upon sound principles, and to preserve the medium of exchange from any deeper fluctuations than those to which it would be occasionally liable were the circulation purely metallic. In 1825, the Bank of England narrowed its issues by upwards of 3,000,000*l.*; but the provincial banks, instead of being able to counteract the operation, by increasing their issues to a corresponding amount, were crushed and extinguished under the calamitous pressure which it occasioned. And, in the present year, when the directors of the Bank of England resorted to measures for contracting the currency, the provincial banks of issue, instead of being able to throw

increased supplies of paper into the channels of circulation, were crippled and paralysed, and compelled to resort to the Bank of England for assistance.

These facts afford experimental proof that, in the particular instances in which they occurred, the directors of the Bank of England had uncontrolled dominion over the circulation of the kingdom, and that when they decreed a contraction of the currency, the provincial banks of issue, instead of resisting, obeyed and suffered. But, upon a subject so important as that now under consideration, it would be neither satisfactory nor safe to rest our conclusions on these particular instances, however striking and decisive they may appear; and I shall therefore proceed to demonstrate, by a reference to general facts and principles, that, if the issues of the Bank of England were regulated by the foreign exchanges, it would be impossible for the provincial banks to keep an excess of paper in circulation.

It will be evident that, if the circulating money within sixty miles of London were wholly metallic, no over-issue of paper, in places exterior to the metropolitan district, could occasion an extension of the currency within that district. In this case, no con-

ceivable increase in the amount of provincial paper could increase the amount of the circulating money of the metropolis; because, by the supposition, this circulating money consists exclusively of coin. But if the increase of provincial paper could not increase the circulating money of the metropolis, neither could it increase the credit money of the metropolis; because, if the metropolitan banks of discount and deposit did not obtain an increased amount of circulating money, to serve as their reserve, or rest, to meet increased occasional demands, they would not be able, with safety to themselves, to make increased advances to their customers; and if the customers of the banks did not obtain increased advances, they could not pay into the banks an increased amount of deposits. It is strictly demonstrable, that if gold was substituted for Bank of England notes in the London district, and if the London banks of deposit and discount were to preserve the due proportion between their reserves and their liabilities, no over-issue of paper, exterior to the London district, could increase the amount, either of the circulating money, or of the credit money, of which the currency of London would, in this case, be composed.

As an excessive issue of provincial paper

could not, if the circulating money of London were metallic, occasion a corresponding expansion in the London circulation, the necessary result of such excessive issue would be, that the currency of the provinces would be rendered redundant, in relation to the currency of the metropolis. Prices would rise in the country markets, without a corresponding rise of prices in the London markets; a greater quantity of goods would be sent from London to the provinces, and a less quantity from the provinces to London; the balance of payments would be turned in favour of London, and against the provinces; and the merchants and dealers of the provinces, who had remittances to effect, would return the excess of paper upon the banks which had issued it, and demand bills upon London in exchange; and hence, to whatever extent the undue expansion of the provincial currency might have been carried, this certain and speedy process of contraction would restore it to par with the currency of London. While the circulating money of the metropolitan district continued to be exclusively metallic, an excessive issue of paper on the part of the provincial banks, could neither render the currency of London redundant, in relation to foreign currencies, nor, for any considerable period, render the provincial currency

redundant, in relation to the currency of London.

There is another important consideration connected with this branch of the subject. If the circulating money of London were wholly metallic, the currency of London would in all ordinary times, remain at par with the metallic currencies of foreign countries; and could never deviate from that par to a greater extent than that measured by the expense of remitting gold. Hence, when the currency of the provinces, in consequence of the over-issue of paper, became redundant, in relation to the currency of London, it would also become redundant in relation to foreign currencies. The merchants of the provinces would import a greater quantity of foreign goods, and export a less quantity of British goods; and, consequently, would have balances to remit to their foreign correspondents. Now, in order to effect these remittances, they would return provincial paper upon the banks which issued it, in exchange for bills upon London; and with these bills they would purchase foreign bills. This might have some effect upon the exchanges; the increased demand for foreign bills might raise their price, until it became profitable to export gold in order to draw against it; and this exportation of gold would occasion some con-

traction in the amount, and some rise in the value, of the London currency. This effect, however, could be only slight and temporary; for the currency of London being previously at par with foreign currencies, a very moderate rise in its value would turn the exchanges in our favour, and bring it back to par. Upon the whole, an over-issue of paper, by the provincial banks, instead of increasing the volume, and reducing the value, of the London currency, would, though to a very slight extent, produce the directly opposite effect, of contracting its volume, and raising its value.

Let us now apply the conclusions at which we have arrived. That which would be true if the circulating money of the metropolis were exclusively metallic, would be equally true if the circulating money of the metropolis consisted exclusively of Bank of England paper, always maintained in the same state, both with respect to amount and to value, in which a purely metallic circulation would exist. Now, if the Bank directors were to regulate their issues by the foreign exchanges, the paper circulation of the metropolis would be exactly equal, both with respect to amount and value, to a metallic circulation; and consequently, every excess of provincial paper would raise prices in the markets of the provinces, without raising them in the

markets of London; would turn the balance of payments against the provinces; cause the excess of provincial paper to be returned upon the banks of issue, in exchange for bills upon London; and, by creating an increased demand for foreign bills, to pay the foreign debts incurred during the high range of provincial prices, would have a tendency to contract the currency of the metropolitan district, rather than to render it redundant. If the directors of the Bank of England were to regulate their issues upon sound principles, the over-issues of the provincial banks would be almost immediately returned upon them, and therefore could not, except for periods too brief to be important, have any sensible effect in increasing the amount, and reducing the value, of the general medium of exchange. While the Bank of England retains its exclusive privileges in the metropolitan district, no considerable or protracted derangement in the money market can take place, except in consequence of the failure of the directors to regulate their issues upon sound principles.

In the actual state of our monetary system, there is a disturbing circumstance, which it would be improper to overlook. The notes of the Bank of England circulate in the provinces to a considerable extent. Hence

were the provincial banks to issue to excess, the Bank of England notes thereby displaced, might be sent to London to pay the balances becoming due from the provinces in consequence of the high range of provincial prices. This would increase the circulating money of the metropolis, enable the London Bankers and bill brokers, to rediscount the bills endorsed by the provincial bankers, and thus occasion an increase of credit money throughout the country. But, for the existence of this disturbing cause, the directors of the Bank of England are exclusively responsible. They have established branches in the provinces; they have made contracts with Joint-Stock Banks for the purpose of inducing them to conduct their business with Bank of England paper, instead of becoming banks of issue; and they have prevailed upon the Legislature to make Bank of England notes a legal tender, so long as they are convertible into gold at the places where they are issued. All these measures are erroneous. The Bank of England should either supply the *whole* circulation of the provinces, or else should supply *no part of it.* While the directors adopt means for the supplying of a *part* of the provincial circulation, without being able to secure the supplying of the *whole,* they

must occasionally be liable to difficulties which they would not have to encounter, were they to limit their issues to the district over which their exclusive privilege extends.

4th.—It has been supposed that the connection which exists between the Government and the Bank of England, deprives the directors of the power of adhering with sufficient strictness to the cardinal and essential principle of regulating the amount of their issues by the course of the foreign exchanges. The Bank of England conducts all the monetary transactions of the Government. "It "acts," says Adam Smith, "not only as an "ordinary bank, but as a great engine of "state. It receives and pays the greater "part of the annuities which are due to the "creditors of the public; it circulates exche-"quer bills, and it advances to Government "the annual amount of the land and malt "taxes, which are frequently not paid till "some years thereafter."

Now, it will be found, upon a careful examination of the matter, that the compound character of the Bank of England, as thus described by Adam Smith, creates no real obstacle to the strict and uniform application of the principle of allowing the amount of its issues to expand and contract under the

influence of the exchanges. In order to relieve themselves from all difficulty and embarrassment in the application of this principle, the directors have only to adopt in their establishment, a proper division of employment, and to keep their functions, as managers of "an "ordinary bank of issue," separate and distinct from their functions as regulators of an "engine of state." Let us see in what way the separation of those functions might be effected.

The business transactions between the Government and the Bank of England, as far at least as these transactions can have any influence on the state of the circulation, are all comprised under two heads, *viz.* holding balances of public money; and making advances to Government on the security of exchequer bills, or on account of the produce of taxes not yet received. Now, in order to present in a palpable and prominent form, the advantage which would result from making these transactions between the Government and the Bank, altogether distinct from its peculiar functions as a bank of issue, and also to show the facility with which such a division of employment might be effected; we have only to consider the manner in which the directors would find it expedient to con-

duct the Government business, if the Bank of England were not a bank of issue.

If the Bank of England were a bank of deposit and of discount, without being at the same time a bank of issue, the directors would conduct the business of the public on the same principles on which a private London banker conducts the business of a private merchant. In the first place, they would deal with public deposits in the same way in which private deposits are dealt with. When the sums paid in on account of the produce of the revenue exceeded the amount required to defray the occasional and periodical charges of Government, they would be employed as a private banker would employ them,—upon available securities bearing interest; and would be re-issued to the public in the purchase of exchequer bills, or of stock, or in the discount of mercantile bills. *This branch of the Government business would, therefore, be conducted without occasioning any contraction of the circulation.*

In the second place, if the Bank of England were a bank of deposit and of discount, without being, at the same time, a bank of issue, the directors, when required to make advances to Government, either for the periodical payments of the dividends, or for any

other purpose, would provide the necessary sums, on the same principles on which a private London banker would provide the means of making advances to his customers. They would realize the requisite amount of cash, by selling the stock and exchequer bills they had purchased with the Government deposits; by monies received in payment of bills discounted; and, if necessary, by resorting to their own capital. By these means, the sums required for effecting the Government payments would first be withdrawn from, and would then be immediately thrown back upon, the channels of circulation; *and therefore this branch of the Government business would be conducted without occasioning an expansion of the currency.*

While the Bank of England, in consequence of its being a bank of deposit and of discount, without being at the same time a bank of issue, would be thus enabled to hold balances for the Government, and to make advances to the Government, without contracting the currency in the one case, or extending it in the other, let us suppose a bank established in London, which is neither a bank of deposit, nor of discount, but simply a bank of issue. Let this bank possess, as the Bank of England now

possesses, the exclusive privilege of supplying the paper circulation of the metropolitan district; but let it have neither branch banks, nor contracts with joint-stock banks, for pushing its notes into circulation in the provinces; let it, when the exchanges are at par, keep one-third of its circulation upon securities bearing interest, and one-third upon the security of treasure in its coffers; let it, when the exchanges become adverse, contract its circulation by selling gold; and when the exchanges become favourable, extend its circulation by purchasing gold. In this case, the circulation of the metropolitan district would be liable to no greater fluctuations, either in amount or in value, than those to which a purely metallic circulation would be liable. As surely as water finds its level, the currency of the provinces would conform to the currency of London; there would be no periodical scarcity of money, and curtailment of accustomed accommodation, requiring occasional departures from principle, in order to support commercial credit; and the transactions between the Government, and the bank conducting the Government business, could not, however great their magnitude, have any effect, either in contracting or in expanding the general medium of exchange.

Let us now make another supposition.

Instead of there being one bank of deposit and discount, for transacting the Government business, and another bank of issue, for supplying the circulation of the metropolis, let us suppose that the directors of the Bank of England form their establishment into two separate departments; the department of discount and deposit, and the department of issue. Let the committee of management entrusted with the department of discount and deposit, conduct the business of Government, and of individual customers, on the ordinary principles which are observed by London bankers, and independently of the department of issue; and let the committee of management presiding over the department of issue, keep their own securities at all times even, and allow the circulation to expand or contract under the action of the exchanges, without reference to the amount either of the securities, or of the balances, or of the advances, which the department of discount and deposit might hold or make. It is obvious, that if this principle of division of employment and separation of functions were adopted, and strictly acted upon, by the directors of the Bank of England, results identical with those described in the preceding paragraph would

necessarily ensue. The circulation, both of the metropolis, and of the provinces, would be maintained in the self-same state in which it would exist, were it exclusively metallic. Occurrences similar to that of the great panic of 1826, or even to that of the mitigated panic of the present year, would become impossible events.

With a view to the immediate Reform of our monetary system, the practical question for consideration is,—are there any insuperable difficulties opposed to the adoption, by the Bank of England, of the division of employment, and of the complete separation of functions above described? Some of the directors of that establishment are masters, not only of the practical details of the money market, but of the scientific principles of money and exchange. The opinions of these enlightened individuals, if known to be sanctioned by the approval of your Lordship, and of the Government, would probably prevail in the deliberations of the Bank parlour. But should the fact prove otherwise,—should a majority of the directors of the Bank of England obstinately refuse to introduce a proper division of employment into their establishment,—then the Legislature will be called upon to determine the question, whe-

ther the medium of exchange should continue to be entrusted to the management of twenty-four London merchants, qualified by being proprietors of Bank stock, elected by their co-proprietors, and having for their first object and primary duty, the protection, not of the public interests, but of their corporate property? Experience would scarcely suggest an affirmative decision of this question.

I shall briefly recapitulate, and conclude. The considerations which I have presented to your Lordship, will, as I venture to believe, be found sufficient to establish the positions :—

That Bank deposits, which may be drawn against at sight, perform the functions of money, and are component parts of the general medium of exchange :—

That a given amount of circulating money becomes the basis of a much larger amount of bank deposits, or credit money :—

That the recent disturbance in the money market was occasioned by the error committed by the directors of the Bank of England, in departing from the principle, of leaving the currency to contract or expand under the action of the foreign exchanges :—

That this error originated in the failure of the Bank directors to distinguish between effects produced upon the general medium

of exchange, by a diminution of their circulation, and by a diminution of their deposits:—

That if the Bank of England were to regulate its issues of paper by the course of the foreign exchanges, the circulation would always remain in the same state, both with respect to amount and to value, in which it would exist were it wholly metallic; and that no over-issue of paper by the provincial banks could have any permanent effect in rendering the currency of this country redundant in relation to the currencies of other countries:—

That the interposition of the Bank of England for the purpose of supporting commercial credit, is necessary in those instances only, in which a previous departure from sound principles by the Bank directors themselves, may have occasioned a sudden contraction of the currency, and have produced a crisis in the money market:—

That if the Bank directors were to adopt a judicious division of employment, in conducting the two-fold operations of the Bank, and to establish a complete separation between its functions as a bank of issue, and its functions as a bank of discount and deposit, no transactions, of whatever magnitude, between the Government and the Bank of England, could interfere with the strict and uniform application of the only sound principle upon which

a paper circulation can be regulated; namely, that of leaving it to contract or expand, as the foreign exchanges become favourable or adverse:—

And that should there exist, under the present arrangements and circumstances of the Bank of England, any practical obstacle to the establishment of a complete separation between the business of issuing paper, and the business of holding deposits and making advances, it will become necessary for the Legislature to place the medium of exchange under the management of competent functionaries, qualified by the possession not of Bank stock, but of economical science; appointed, not by the holders of Bank stock, but by the Government; responsible, not to their co-proprietors, but to Parliament; and having for their first object and primary duty the protection, not of their own corporate property, but of the general interest of the nation.

Whether the division of employment which I have suggested can, or cannot be effected, the Bank of England, on the expiration of its existing charter, should be deprived of the power of issuing paper, and of controlling the currency. On this subject there cannot be a more competent authority than Mr. Clay, who, in his recent publication upon Joint Stock Banks, thus expresses himself:—

"The really serious evil incident to the use of "paper money, is the danger of its being issued in "excess. If ten millions of notes on the security "of twenty millions of consols were issued to-"morrow, their effects on the welfare of the com-"munity would be as ruinous as if they had been "issued by parties not worth a shilling. There is, "in truth, but one course by which we can hope to "place the currency in a permanently sound and "healthy state, *viz.*—by not conceding to any "private parties whatsoever, whether individuals, "associations, or bodies corporate, the privilege of "issuing notes. That power should be in the "hands of the state alone. To such course justice "and sound policy alike point;—justice, because "in whatever advantage is to be derived from the "substitution of paper for metallic money, every "member of the community is entitled to par-"ticipate;—policy, because by such course alone "can this dangerous power be secured from the "abuses which cupidity or ignorance may engender. "The difficulties which have been apprehended "from vesting this power in a parliamentary com-"mission will, I am satisfied, when fairly grappled "with, prove to be wholly imaginary; I exceed-"ingly doubt whether there be one practical 're-"form' in our power to effect, of such unmixed "good."

Trusting that the great practical importance of the subjects which I have now attempted to illustrate, will be received as my apology for thus addressing myself to your Lordship, I have the honour to be,

My Lord,

Your Lordship's most obedient, and

Most humble Servant,

R. TORRENS.

APPENDIX.

No. I.

Paper by Mr. Pennington, reprinted from the Appendix to Mr. Tooke's first Letter to Lord Grenville on the resumption of Cash Payments.

Mr. Tooke has shown that the fluctuations which took place in the value of the currency, beyond the degree indicated by the difference between paper and gold, during the suspension, and those which have occurred since the resumption of cash payments, were the result of circumstances which it was not in the power of the Bank of England to control or regulate. In describing the effect of those circumstances upon that portion of the currency which is not dispensed by the Bank of England, it was sufficient for the purpose of his argument to show that country bank notes, private paper, and credit, are susceptible of considerable increase or diminution, without a corresponding enlargement or contraction of the basis on which they rest. He does not appear to have thought it necessary to describe each particular mode in which credit, in its various forms, is substituted for currency, but has contented himself with showing that it is much more extensively employed at one period than at another.

There is, however, one modification of credit connected with the private banking establishments of London, of which, although the explanation can add nothing to the force and correctness of Mr. Tooke's argument, it may possibly serve to place in a clearer view some of the circumstances and considerations to which he has adverted. Those establishments are commonly regarded merely as banks of deposit; and it is supposed that they cannot, under any circumstances, by enlarging or contracting the currency, affect its value.

This notion, which has long been a prevailing, and is apparently a very natural one, will be found, on examination, to be wholly incorrect. It may be shown that they are essentially banks of circulation, differing from the country banks chiefly in the mode in which their promises to pay are transferred from one person to another, and not in any material circumstances connected with the promises themselves.

In some respects, undoubtedly, they resemble the old banks of deposit—they receive and pay money on account of merchants and others, and they allow no interest upon the money lodged with them. But there is this material and important difference, that while the former are allowed to make what use they please of the money entrusted to their care, upon the sole condition of being able to discharge, with promptitude and regularity, the fluctuating and occasional demands made upon them by the depositors, the latter are not permitted to avail themselves of this advantage, but are bound to preserve, in kind, the coins and bullion deposited with them.

Of the money placed in the hands of the London bankers, the largest proportion is employed in discounting bills of exchange, in the purchase of Exchequer Bills, in advances upon stock, and on other readily convertible securities. Now, as the money so employed, although drawn out of the hands of bankers by one set of persons, is repaid to them by another, it is obvious that the aggregate amount of money, in the hands of all the bankers collectively, will always be the same; and that their engagements, or the balances due to the merchants, traders, and others, for whom they act as bankers, will be increased by the money so repaid to them.

In order to simplify the consideration of this subject, let it be supposed that, instead of seventy London bankers, there is only one, and that this single bank engrosses all the business of the metropolis—let it be further supposed that the Bank of England notes and gold lodged with it amounted, on its first establishment, to ten millions, and that of these ten millions, five millions were employed in the purchase of Exchequer Bills, it is obvious that the sellers of the bills, whether the State or private individuals, would not have parted with them unless they had wanted money for the purpose of discharging a debt or of effecting a purchase—in either

case, the parties to whom it was finally paid would, for their own convenience, pay it into the hands of the Bank on their own account; and thus the Bank would become repossessed of the identical five millions which it had previously lent, and the balances which it owed to its various depositors would, by this new deposit, be increased from ten to fifteen millions, of which five millions would be represented by Exchequer Bills.

In whatever degree the Bank multiplied its transactions of a similar kind, the result would be similar—every additional loan or purchase would terminate in its having the same amount of Bank of England notes and gold in its possession as before, and in its liabilities to its depositors being increased.

If we take the case of two or more bankers, instead of one, the process above described will be found essentially similar, and its effects the same. If A and B have each five millions deposited with them, and A lend two millions upon securities bearing interest, it is probable that one of the two millions will be re-deposited with A, and that the other million will be deposited with B; A will then owe six millions, and B will owe six millions. If, afterwards, B lend two millions, it is probable that one of the two millions will be re-deposited with B, and the other million with A: they will then each owe seven millions; and thus the process will be continued until, together, they owe fifteen millions, of which five millions will be represented by Exchequer Bills.

Whether there are one, or two, or seventy banks, the real state of the case is still the same, the money withdrawn from one bank being always again lodged in that or in some other bank; the total amount of Bank of England notes and coin in the hands of all the bankers, although distributed in varying proportions amongst them, is neither increased nor diminished. The more, however, they enlarge their loans, the more are the balances due to depositors augmented; and as merchants, traders, and others, rate their command of money by the amount for which they are credited in the books of their respective bankers, these credit balances transferred, in whole or in part, from the account of one person to that of another, in the books of the bankers, perform precisely the same functions as the like amount of bankers' notes would do circulating amongst the depositors. They are transferable book-debts, convertible into the coin of the realm at the

pleasure of those to whom they are due: the notes of a country banker are essentially the same thing—the book credits of a London banker, and the notes of a country banker, are but two different forms of the same species of credit.

In the imaginary cases above stated, it is supposed that the operations of the bankers, which produce an enlargement of the currency in the manner described, take place suddenly and at once: in reality, however, they would be slow and gradual; each banker would be disposed to extend his discounts and increase his purchases by little and little, and a considerable time would probably elapse before they became of considerable magnitude.

It will, perhaps, be said that, although such a process as is here described, may possibly take place when there are only two banking establishments, yet when there are so many as seventy, they will operate as a check upon each other; and that, if any one of them should venture unduly to extend its discounts or its purchases, it would be warned of its imprudence by an inconvenient diminution of its cash reserve: all the cheques drawn upon this bank, for the amount of its new investments, might be paid into the hands of other bankers, and a regard to its own safety would then be an inducement to re-discount or re-sell them.

This consequence would undoubtedly ensue, if the advances were hastily and injudiciously made; and it is precisely this consideration which retains country bankers, whose circulation is in the same neighbourhood, or within the same sphere, from a sudden and improvident extension of their issues. There are, in Edinburgh, five or six circulating banks, of which the notes of each are continually falling into the hands of the others. Twice a week they exchange notes with each other, and liquidate the balance arising therefrom, by a payment of Bank of England notes, or by a short-dated bill upon London, exactly upon the same principle, and with the same intention, as require the daily liquidation, at the clearing-house, of the cheques upon each other by the London bankers. If any one of the Edinburgh banks were unduly to increase its issues, a greater number than usual of its notes would fall into the hands of the neighbouring banks, and that bank would have to pay a larger balance than usual, in

London money, at the period of weekly liquidation. Each is thus a restraint upon the other; and they are all obliged to manage their business with care and circumspection.

But neither the extension of the book credits of the London bankers, nor an increased circulation of country notes, ever takes place so suddenly or so largely as to create the inconvenience here alluded to. It is slowly and gradually, when credit is high and expectation on the wing, and under circumstances which encourage extraordinary speculation, that bankers are induced greatly to extend their circulation; each being persuaded that, at such a period, his competitors will pursue the same course, and, by so doing, prevent the inconvenient payment to each other of large balances, at the period of mutual liquidation.

On the other hand, during a period of distrust and difficulty, the reverse of these operations takes place. Each banker is anxious to increase his cash reserve, and to lessen the amount of his outstanding engagements. But if the amount of Bank of England notes and gold, in the hands of the seventy London bankers, collectively, remain the same, the aggregate amount of their outstanding engagements can be lessened only by parting with a portion of the productive securities in their possession. To part with any portion of their productive securities will, upon the principle above explained, necessarily diminish the amount of the deposits. There will be less of what is called money—of what is substituted for metallic money—and the pressure and the obstruction, occasioned by this contraction of the currency, will, in all probability, continue, until fallen prices, a rise of the foreign exchange, and an influx of bullion, have restored the currency to its former level.

It may, however, be said, that the money advanced by the bankers may, very possibly, be withdrawn from them in the shape of Bank of England notes and coin, and that the notes and coin so withdrawn may be paid into the hands of those, the nature of whose business and pecuniary operations does not require the intervention of a banker; and that, whenever this happens, not only will the bankers be deprived of a portion of their cash reserves, but the aggregate amount of deposits will be lessened.

This, no doubt, would frequently be the case, if that class of persons, whose receipts and payments are of such a nature as not

to require the aid and intervention of a banker, bore a large proportion, in point of numbers, to those whose business cannot conveniently be carried on without one. But, in London, by far the largest proportion of the ordinary receipts and payments are effected through the medium of the private bankers, and most of the cheques drawn upon them are, therefore, liquidated at the clearing house; few, comparatively, being paid in gold and Bank of England notes at the counter.

As this objection applies, with equal force, to the provincial and the London currency, it may be useful to examine it more at large.

Two things are necessary to the existence of a paper in the place of a metallic currency, namely:—

1. A perfect willingness on the part of the people to use paper instead of coin, as the instrument of circulation, and its equal or greater convenience for that purpose.

2. The charge of no higher a rate of interest than the current rate, by the issuers of it.

With respect to the first condition, it may be observed, that if the willingness and the convenience therein involved, should extend only to a comparatively small class of persons, no efforts of the bankers, no loans or discounts at a low rate of interest, would enable them to keep out their notes to a greater extent than the persons of that class, collectively, deemed it necessary to keep by them to answer current and occasional demands. If the issues of the paper went beyond that limit, the redundant notes would fall into the hands of the other classes of the community, and immediately be brought to the Bank for payment; they would not remain out, for the channel in which alone they can circulate is already full; they would not lower the value of the rest of the currency, for, to produce that effect, would require a considerable time; they would immediately recoil upon the bank that issued them.

But when the habitual use of paper money obtains amongst all classes of the community, and no preference, arising from convenience, caprice, or habit, of paper to coin, exists in any class—when its quantity far exceeds in amount that of the coins which circulate along with it—there will exist, so far as the internal trade of the country is concerned, no motive for its conversion. It may *then*

be issued to excess, and continue in circulation sufficiently long to raise general prices and depress the foreign exchange, the check arising from which will ultimately bring it down to its natural level.

It should seem therefore, that in a country of which the paper circulation is confined to the convenience of a few, and of which a very large proportion of the currency is metallic, a check, independent of the foreign exchange and the rate of interest, exists, to prevent an excessive issue; and that when the habitual use of paper money obtains amongst all classes of the community, and the coins bear but a small proportion to the paper, the only checks are the discretion of the bankers, the charge of a high rate of interest, the depression of the exchange, and the efflux of the metals.

If, in a country of which the currency is mainly metallic, a bank, similar in its plan to that of the private banking-houses of London, were established, the managers of that bank would lend at interest a large proportion of their deposits, and, by that means, lower the value of the currency, and force forth the country a sum of money equal, or nearly equal, to the amount of their loans. By this process the value of the currency would be restored to its original level. If, for instance, previously to the establishment of the bank, the currency amounted to sixty millions, and deposits were made to the extent of ten millions, the bankers might think themselves safe in lending eight millions. Those eight millions would, in no long time, be forced out of the country, and fifty-two millions (of which two millions would be the dead reserve of the bank) would perform all the functions which sixty millions had done before. It is probable that whenever it made advances in the way of loan or discount, five-sixths of those advances would fall into the external circulation*, and one-sixth only be re-deposited; it would, therefore, be acted upon by a double check, namely, the external currency, and the foreign exchange: the operation of the first would be immediate—that of the latter slow.

But if the practice of depositing money in a bank so constituted should prevail to such an extent as to increase the deposits to fifty

* The phrase *external circulation* is here used to denote those payments which are made without the instrumentality and intervention of a banker.

millions, and to reduce the external currency to ten millions, the whole currency would then consist of sixteen millions of coin (of which six millions would be the dead reserve of the bank) and fifty millions of book debts, or promises to pay. The power of the Bank to alter the value of the currency would, now, be very different from what it was in the former case. Now, whenever it made advances, five-sixths of those advances would, in all probability, be re-deposited, and one-sixth only fall into the external circulation. The check arising from the external currency would be diminished in the proportion of five-sixths to one-sixth; that arising from the foreign exchange would be the same as before; the latter, however, would be slow in its operation.

If the foregoing observations on the nature and instrumentality of the private banking establishments are correct, they may possibly serve to obviate, or, at least, to lessen some of the difficulties with which the subject of the currency has heretofore been surrounded. They will show that the money of the metropolis does not consist only of Bank of England notes and coin, but that by far the largest portion of it is formed of the transferable book debts of about seventy private banking establishments; which book debts, although convertible into Bank notes and coin at the pleasure of those to whom they are due, are susceptible of considerable expansion and contraction, without a corresponding enlargement or diminution of the basis on which they rest.

This state of the London currency—this capability of increase and dimunition of the money created by the London bankers—is productive of many important consequences. The provincial circulation, as well that part of it which consists of country bank notes, as that which consists of bills drawn upon London, is mainly dependant on it. Practically, indeed, and upon all ordinary occasions, the book debts of the London bankers, and not Bank of England notes, are the solvent of the country circulation; and as the London currency may increase or diminish without a corresponding alteration of the Bank of England issues, so likewise may that of the country. That the variations of the latter have not been conformable to the Bank issues, is a well known fact; that the book-credit money of the London bankers has as little been conformable to them, may reasonably be con-

jectured. Hence it has not unfrequently happened, that general prices have risen, and been kept at a high range for a considerable period of time, without any augmentation of the issues of the Bank of England; and that they have frequently fallen, and been for a long time depressed, while those issues have continued uniform, or been on the increase.

APPENDIX.

No. II.

Paper communicated by Mr. Pennington.

I WILL endeavour to explain, as succinctly as the nature of the subject will permit, the principle on which I apprehend the system of private banking in the metropolis is conducted, and the mode in which it works. To this end, I must request that you will have the goodness to go along with me in certain suppositions, which it will be convenient to adopt, in order to render the statement distinct, and to facilitate the inquiry.

Suppose, then, that there are in the metropolis fifty private banking establishments, and that the balances, payable on demand by each to its various customers, are, on the average, 500,000*l* Suppose, moreover, that the outstanding notes of the Bank of England are eighteen millions, and that of these, 5,000,000*l*. are in the hands of the private bankers, that 5,000,000*l*. are in the hands of those, the nature of whose business does not require the intervention of a banker, and that 8,000,000*l*. are circulated in the country districts. The money of the metropolis will, on these suppositions, consist of 25,000,000*l*. of the book debts, or promises to pay on demand, of the private bankers, and of 5,000,000*l*. of Bank of England notes, together 30,000,000*l*. That under the circumstances supposed, the sum of 30,000,000*l*. will be the whole amount of London money, will appear evident from this consideration, namely, that if any merchant, trader, or other person in the metropolis, should truly say, that he has money in his possession, or at his command, applicable to the payment of a debt, or to the effecting of a purchase, that money must consist either of a portion of the 25,000,000*l*. of bankers book debts payable on demand, or of a portion of the 5,000,000*l*. of Bank of England notes.

The first and most important question is, whether the private bankers have the power to increase or diminish the quantity of money in the metropolis, so long as the circulation of the Bank of England remains stationary. The prevailing opinion is, that they have no such power—that they cannot create, or cancel, money by an enlargement or contraction of issues—that the amount of money is not, in the least, affected by their operations—that they can lend only what has been lent to them—and that their profits consist of the interest derived from the loan of their deposits.

This opinion appears to me to be, in many respects, a mistaken one. Let us try it in its application to the supposed state of things above described. The supposition is, that the balances due from each of the private bankers amount to 500,000*l*., and that each has a reserve of 100,000*l*. in Bank of England notes. If, under these circumstances, the money market be smooth and easy, and great confidence prevail, it is very possible that some of the London bankers (suppose ten) may think that a reserve of 100,000*l*. is more than sufficient to answer current and occasional demands at the counter and at the clearing house, and may therefore be willing to make further advances to the extent of (say) 40,000*l*. each. In this case, what will happen? Either the 40,000*l*. will be withdrawn in Bank of England notes, from each of the ten bankers who agreed to make the advance, and form an addition to the 5,000,000*l*. circulating amongst those whose business and money transactions do not require the intervention of a banker, or the bank notes withdrawn, will be distributed in some proportion, by means of cheques, amongst the fifty London bankers, or they will be disposed of partly in the one way, and partly in the other. In whatever way the 400,000*l*. of Bank notes are disposed of (unless they go to the Bank of England, and are not re-issued), the money of the metropolis will be increased from 30,000,000*l*. to 30,400,000*l*. Some persons or other will have in their possession, or at their command, 400,000*l*. *more* money than they had before: no one will have *less* than he had before.

For the sake of fixing our ideas, let us suppose that of the 400,000*l*. of Bank notes withdrawn from the ten bankers, one-

sixth (66,666*l.*) fall into the external currency of 5,000,000*l.*, or, in other words, into the hands of those who do not employ bankers; and that the remaining five-sixths (333,333*l.*) are distributed in equal proportions amongst the fifty bankers; and let us then contrast the money of the metropolis as it stood previously, with its state as it stood subsequently to the operations above mentioned.

Before the advance of 400,000*l.* took place, the account of the money circulation stood thus:—

Fifty bankers had in bank notes...	£. 5,000,000	
in securities...	20,000,000	
		£.25,000,000
External currency in the hands of those not employing bankers—Bank notes		5,000,000
Total money of the metropolis ...		£.30,000,000

Subsequently to the advance, the account will stand as follows:—

Ten bankers—Bank notes	£.1,000,000		
Less withdrawn ...	400,000		
	£.600,000		
New deposits—one-fifth of £.333,333	66,666		
		£.666,666	
Deposits, represented by securities—old	4,000,000		
——— new......	400,000		
		4,400,000	£.5,066,666
Forty bankers—Bank notes	400,0000		
New deposits—four-fifths of £.333,333	266,666		
		4,266,666	
Securities		16,000,000	
			20,266,666
External currency ..			5,066,666
Total money of the metropolis...			£.30,400,000

But this is not all. The forty bankers who have not ventured to make further advances, will, if the confidence in the money market remain unimpaired, in all probability, be disposed to follow the example of their neighbours, especially after finding that their stock of Bank notes has been increased by new deposits to the extent of 266,666*l.* Let us suppose that they do accordingly make additional advances upon securities to the extent of 1,600,000*l.*, or 40,000*l.* each, and that the Bank notes withdrawn from them are distributed in the same manner, and in the same proportions, as in the case of the ten bankers.

The account of the London currency will then stand as follows:—

Forty Bankers — Bank notes..........................	£.4,266,666		
Less withdrawn..........	1,600,000		
	2,666,666		
Paid in 4-5ths of 1,333,333	1,066,666		
		3,733,333	
Deposits, represented by securities—old	16,000,000		
———— new.........	1,600,000		
		17,600,000	
			21,333,333
Ten Bankers—Bank notes...	666,666		
Paid in 1-5th of 1,333,333...	266,666		
		933,333	
Deposits, represented by securities..................		4,400,000	
			5,333,333
External currency......................			5,333,333
Total London money.....			£32,000,000

It thus appears that the quantity of money in the metropolis will have increased, without any augmentation of Bank of England notes, from 30,000,000*l.* to 32,000,000*l.*, and that the bankers will have experienced no greater reduction in the amount

of the Bank notes which they previously held than 6666*l.* each, or 333,333*l.* in all, which 333,333*l.* will have been added to the external currency—to the Bank notes which circulate amongst those whose business and money transactions do not require the intervention of a banker.

If public and private credit continue undisturbed, similar operations may be repeated, until the amount of London money is increased from 30,000,000*l.* to 40,000,000*l.* without reducing the reserve of Bank notes in the hands of the London bankers below 3,333,333*l.* in the whole, or 66,666*l.* each.

The converse of these operations would produce opposite effects. During the prevalence of discredit and alarm, each banker is desirous of increasing his reserve of Bank notes; but as, by the supposition, the whole amount of Bank notes in the metropolis does not exceed 10,000,000*l.*, of which 5,000,000*l.* are in the hands of the bankers, and 5,000,000*l.* in the hands of those who do not employ bankers, a banker can increase his cash reserve only by abstracting Bank notes from the hands of some one, or all, of the other bankers, or by obtaining them from the *external currency*. If, by disposing of a part of his productive securities, he succeed in the attempt, it is probable that all the other bankers will be induced to follow his example. There will thus be a struggle for Bank notes, the effect of which will be a diminution of the credit money in London. If the bankers dispose of 5,000,000*l.* of their securities, their balances will be reduced from 30,000,000*l.* to 25,000,000*l*, their Bank notes increased from 5,000,000*l.* to 5,833,333*l.*, and the external currency be reduced from 5,000,000*l.* to 4,166,666*l.*

In the foregoing statements the metallic money circulating in the metropolis is not specifically mentioned. In order to avoid prolixity, the gold and silver are considered as included in the 10,000,000*l.* of Bank notes.

In attempting to illustrate the principle on which I apprehend the quantity of London money may be increased, under certain assumed circumstances, by the operations of the London bankers, I have proceeded on the supposition that these operations take place suddenly and at once, and are conducted according to a certain scale of uniform proportions.

NOTE *to Page* 28.

The rule adopted by the Bank directors, of keeping their securities even, and of leaving the whole of their liabilities to be acted upon by the foreign exchanges, would be conformable to principle, if the Bank of England were simply a bank of issue, and had no liabilities consisting of deposits. But, as the Bank of England is a bank of deposit, as well as a bank of issue, this vaunted rule is not only contrary to principle, but is impracticable. An example will make this palpable. If the circulating money of this country were so redundant, as to require a contraction to the amount of 1,000,000*l.*, in order to bring the currency to par with foreign currencies; and if the merchants, who, under the adverse exchange, had remittances in specie to effect, were to return upon the bank 1,000,000*l.* of its paper, in exchange for gold, to be exported; then the requisite contraction of the circulating money would be effected, and the adverse exchange would cease. But if the merchants, who had this amount of specie to remit, had deposits, and drawing accounts with the Bank, and if they were to draw out their deposits in gold, for exportation, then no contraction of the circulating money would be effected; the currency would remain in excess, and the exchanges would continue to be adverse. Let us suppose, that when the exchanges turn against us, the Bank has a reserve of bullion to the amount of 8,000,000*l.*; and that the merchants having foreign remittances to effect, have deposits and drawing accounts with the Bank to a similar amount. In this case, if the directors were to adhere to their rule of keeping their securities even, the process of drawing out deposits in gold, for exportation, might proceed until the coffers of the Bank were completely exhausted, without a single note being

abstracted from the amount of circulating money, and consequently without any contraction of the currency, or correction of the exchanges. Under such circumstances, however, the directors would throw their rule overboard. Instead of keeping their securities even, they would sell exchequer bills, narrow their discounts, and thus suddenly, and rapidly, contract the circulation, until the superstructure of credit currency began to give way, and it became necessary, in order to avert a domestic panic, that the Bank should exercise its otherwise dormant function of supporting commercial credit.

When Lord Spencer brought forward the Government measure for renewing the Bank charter, I endeavoured, in my place in the House of Commons, to explain this intricate and important subject. But no time for consideration was allowed; and the most important bill of the session was hurried through the House with disastrous haste.

PUBLISHED BY THE SAME AUTHOR,

Essay on the External Corn Trade. Fourth Edition.

On the Colonization of Australia. Second Edition.

Wages and Combinations. Second Edition.

Letters on Commercial Policy.

Substance of a Speech delivered in the House of Commons, on Emigration to the British Colonies.

Essay on the Production of Wealth.

LONDON:
PRINTED BY T. BRETTELL, RUPERT STREET, HAYMARKET.